**American Banker**, July 11, 2012

# No Wonder Eminent Domain Mortgage Seizures Scare Wall Street

Rep. Brad Miller

There is a great disturbance in the force.

Wall Street's political operatives — the American Bankers Association, American Securitization Forum, the Securities Industry and Financial Markets Association, and the Financial Services Roundtable — wrote a panicked letter to the Supervisors of San Bernardino County in California to express "strong objection" to a proposal by a startup mortgage company. The letter conveys the unmistakable threat that Wall Street will sic its lawyers on the county and will "likely be reluctant to provide future funding to borrowers in these areas."

The proposal is that the county use eminent domain to buy underwater mortgages, almost half the mortgages in the county. The mortgage company, working with the county, would then negotiate new mortgages with the homeowners that they could afford. If the proposal worked as planned, the county would get relief from the foreclosure crisis, the mortgage company would make a profit, and the idea would spread to other counties and towns.

A legal challenge by Wall Street might be expensive to fight, but the arguments are pretty flimsy.

Eminent domain is commonly used to buy land for projects like roads and schools. Existing law allows the use of eminent domain to buy any kind of property, however, including even intangible property like trade secrets. There is no apparent reason that eminent domain could not be used to purchase mortgages.

The Constitution requires only that the county pay fair market value and that there be a public purpose. Deciding a fair price would not be hard. There are frequent auctions of mortgages with a sufficient number of informed, sophisticated buyers. The auctions are an almost perfect pricing mechanism. There would be comparable sales to determine almost any mortgage's fair market value.

Showing a public purpose would not be hard either. A public purpose can be cleaning up contaminated land, renewing a "blighted" neighborhood, or even stimulating economic growth by replacing residential neighborhoods with commercial development.

Wall Street argues that the county's purpose would not be to reduce the foreclosures that are wreaking economic havoc, but to enrich the mortgage company. But law professors, economists, community advocacy groups and politicians with no financial interests at stake have argued for just such an effort to address the foreclosure crisis. A program by a government agency not motivated by the pursuit of profit would be greatly preferable, but this proposal by the for-profit mortgage company obviously serves a public purpose.

The threat of a boycott is also hollow. A decade ago Wall Street bullied Georgia into gutting a state predatory lending law by refusing to buy Georgia mortgages. Wall Street has not bought mortgages since the collapse of the private securitization market five years ago, however. A threat of a boycott by Fannie Mae and Freddie Mac would be credible, but the threat of a boycott by Wall Street is not.

Wall Street quickly persuaded some mortgage investors, such as pension funds and insurance companies, to oppose the proposal, but investors will do fine – maybe even better than they would otherwise. The program would likely target homeowners with second liens. Mortgage investors own most first mortgages, but the biggest banks own most second mortgages and home equity lines of credit.

About half of delinquent first mortgages also have second liens. Second liens are secured by the value of the home in excess of the amount of the first mortgage. Since the housing bubble burst, there often is no excess. At foreclosure, first mortgage holders are paid in full before second lien-holders are paid anything, and the holders of seconds usually come away empty-handed. Courts give firsts the same priority over seconds in bankruptcy.

Second liens have a ransom value in voluntary modifications, however. Unless the second lien-holder agrees to something different, the voluntary reduction of principal on a first mortgage is a gift of collateral to the second lien-holder and may still not get the homeowner above water. Second lien-holders sometimes offer to reduce the second by the same percentage that the first is voluntarily reduced, a far cry from the priority in foreclosure and bankruptcy. Mortgage servicers, the companies responsible for negotiating voluntary modifications of first mortgages owned by investors, frequently have a stunning conflict of interest. The four biggest banks - Bank of America, JPMorgan Chase, Citigroup and Wells Fargo - control two-thirds of all mortgage servicing, mostly of mortgages owned by investors. The same four banks hold $363 billion in second liens, very commonly on the same property as first mortgages they service.

So the real losers from the program would be the biggest banks, the holders of second liens, not investors in first mortgages. And even for the biggest banks, eminent domain would not cause losses but reveal losses.

The biggest banks have delayed recognizing losses on seconds for years while paying dividends and lavish executive bonuses. Involuntary sales of seconds at fair market value would end fictitious valuations and require an immediate accounting loss, making dividends and executive bonuses much harder to justify and perhaps even revealing some banks to be insolvent.

The biggest banks have used their political power in Washington to defeat any effort that would effectively reduce foreclosures, such as allowing judicial modification of mortgages in bankruptcy, allowing a federal agency to use eminent domain to buy mortgages, or providing teeth for the chronically ineffective Home Affordable Modification Program, because those efforts would also require the immediate recognition of losses on mortgages.

But Wall Street's power in Washington may be as useless in defeating a proposal in San

Bernardino County as strategic nuclear weapons are in fighting an insurgency. No wonder Wall Street is panicked.

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